

## Internal Revenue Service

Number: **200708012**

Release Date: 2/23/2007

Index Number: 355.01-01, 356.00-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:01

PLR-133229-06

Date:

November 08, 2006

### LEGEND:

Distributing =

Controlled =

State X =

State Y =

Distributing Common Stock =

Controlled Common Stock =

Business 1 =

Business 2 =

Controlled Management Team =

Controlled Management Team =

Controlled Management Team =

a =

b =

c =

d =

e =

f =

g =

h =

Date A =

Dear :

This letter responds to your July 3, 2006 request for rulings regarding certain federal income tax consequences of a proposed transaction. Additional information was submitted on August 8, 2006, August 17, 2006, September 5, 2006, September 13, 2006, and November 8, 2006. The information submitted is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an

appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. Moreover, no information provided by the taxpayer has been reviewed and no determination has been made regarding whether the proposed transaction: (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see § 355(a)(1)(B) of the Internal Revenue Code (the “Code”) and § 1.355-2(d)), or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a fifty percent or greater interest in the distributing corporation or the controlled corporation (see §§ 355(e)(2)(A)(ii) and 1.355-7).

## SUMMARY OF FACTS

Distributing is a State X and Controlled is a State Y accrual basis corporation. Distributing is the parent of Controlled and files a consolidated federal income tax return. Distributing has a single class of voting common stock outstanding, which is widely held but not publicly traded. All of the Distributing Common Stock is owned, directly or indirectly, by employees, non-employee directors and former employees of Distributing or Controlled. Approximately a% of Distributing Common Stock is held by former employees.

Controlled has a single class of voting common stock outstanding. Distributing directly owns all of the Controlled Common Stock.

Distributing conducts Business 1. Controlled conducts Business 2. Financial information has been received indicating that both Business 1 and Business 2 have had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

The growth of the number of employees working for Distributing has caused Controlled to fail to qualify as a small business under government contracting regulations. In order to regain the benefits of status as a small business and in order to enable Controlled to improve its competitive position, Distributing plans to exchange all of the issued and outstanding Controlled Common Stock beneficially owned by Distributing for outstanding Distributing Common Stock (the “Exchange”). Only Controlled employees and the Controlled Management Team (collectively, the “Eligible Shareholder(s)”) will participate in the Exchange.

The Eligible Shareholders own approximately b shares of the Distributing Common Stock. Controlled Management Team Member 1 owns approximately c shares and Controlled Management Team Member 2 owns approximately d shares of Distributing Common Stock. The Eligible Shareholders will exchange approximately e shares of

Distributing Common Stock for all of the Controlled Common Stock. The Controlled Management Team may obtain most or all of the Controlled Common Stock in the Exchange.

Some Eligible Shareholders may exchange all of their stock in Distributing solely for Controlled Common Stock ("Exchanging Shareholders"). Other Eligible Shareholders may exchange part of their Distributing Common Stock for Controlled Common Stock and the remainder of their Distributing Common Stock will be subject to the redemption program ("Redeeming Shareholders").

#### PROPOSED TRANSACTION

To accomplish the separation of Controlled from Distributing, Distributing has proposed the following transactions:

- (i) Upon obtaining approvals from applicable federal and state agencies under applicable securities laws and regulations, Distributing will solicit offers for the Exchange from Eligible Shareholders.
- (ii) Following step (i), Distributing will determine the number of shares of Distributing Common Stock that each Eligible Shareholder will be permitted to exchange for Controlled Common Stock. Such shares are designated "Accepted Shares." The aggregate number of Accepted Shares will have a value, based on the formula stock price of Distributing Common Stock as of the date of the Exchange, of approximately \$f.

In accordance with the provisions of a share exchange agreement between Distributing and the Controlled Management Team from Date A, Controlled employees will receive priority in the Exchange. If the Exchange is oversubscribed, then the number of shares that each participating Controlled employee shall be permitted to exchange will be equal to his or her pro rata share (rounded to the nearest whole share) based on the ratio of the number of shares tendered by such employee to the total number of shares tendered by all participants. If the Exchange is undersubscribed by Controlled employees, then the Controlled Management Team will be obligated to tender additional shares so that the aggregate value of the Distributing Common Stock to be exchanged will equal the value of the Controlled Common Stock. If at least g% of the total number of Distributing Common Stock to be exchanged is not provided by Controlled employees, the Controlled Management Team may terminate the Exchange, at its discretion.

- (iii) Following step (ii), Distributing will make a cash contribution of approximately \$h to Controlled (the "Contribution"). Controlled Common Stock will not be issued to Distributing.

- (iv) The Exchange will follow step (iii) and immediately thereafter, the remaining Distributing Common Stock owned by any Eligible Shareholder will be subject to repurchase, at Distributing's option and in accordance with Distributing's customary procedures for the repurchase of Distributing Common Stock owned by any person who ceases to be employed by Distributing or any subsidiary of Distributing (the repurchases, together with the Exchange, are referred to as the "Split-Off").

## REPRESENTATIONS

The taxpayer has made the following representations concerning the Split-Off:

- (a) The fair market value of the Controlled Common Stock and other consideration to be received by each holder of Distributing Common Stock pursuant to the Split-Off will be approximately equal to the fair market value of the Distributing Common Stock surrendered by the shareholder in the Split-Off.
- (b) No part of the consideration to be distributed by Distributing to Distributing shareholders will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operations, and with regard to Distributing, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) The five years of financial information submitted on behalf of Controlled is representative of Controlled's present operations, and with regard to Controlled there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Following the Split-Off, each of Distributing and Controlled will continue the active conduct of its business independently and with its separate employees.
- (f) The distribution of Controlled Common Stock is carried out for the corporate business purpose of enabling Controlled to certify itself as a small business under government contracting regulations and by enabling Controlled to improve its competitive position by reducing its general and administrative rate for government contracting purposes. The distribution of Controlled Common Stock is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (g) The Split-Off is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.

- (h) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled Common Stock, other than payables and receivables that arise in the ordinary course of business.
- (i) Immediately before the Split-Off, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. Furthermore, any excess loss account Distributing may have with respect to the Controlled Common Stock will be included in income immediately before the distribution.
- (j) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled, will be made for fair market value based on the terms and conditions arrived at by the parties bargaining at arm's length.
- (k) Neither Distributing nor Controlled is an investment company as defined in § 368(a)(2)(F)(iii) and (iv).
- (l) For purposes of § 355(d), immediately after the Split-Off, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing Common Stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing Common Stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Split-Off.
- (m) For purposes of § 355(d), immediately after the Split-Off, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled Common Stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled Common Stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Split-Off or (ii) attributable to distributions on Distributing Common Stock that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Split-Off.
- (n) The Split-Off is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).

## RULINGS

Based solely on the information submitted and the representations set forth above, we rule as follows:

- (1) The Contribution, followed by the Split-Off, will qualify as a reorganization within the meaning of 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" within the meaning of § 368(b).
- (2) Distributing will not recognize any gain or loss on the Contribution. Section 361(a).
- (3) Controlled will not recognize any gain or loss on the Contribution. Section 1032(a).
- (4) Distributing will recognize no gain or loss on the Distribution. Sections 355(c)(1) and 361(c)(1).
- (5) No gain or loss will be recognized by (and no amount will be included in the income of) the Exchanging Shareholders upon the receipt of Controlled Common Stock pursuant to the Split-Off. Sections 355(a)(1) and (2).
- (6) The Redeeming Shareholders will recognize gain, if any, on their receipt of the Controlled Common Stock and redemption proceeds in the Split-Off, but not in excess of the fair market value of the redemption proceeds received. Section 356(a)(1). For purposes of § 356, the Redeeming Shareholders will be treated as if they had retained the Distributing Common Stock actually exchanged for the Controlled Common Stock and received the redemption proceeds in exchange for Distributing Common Stock equal in value to the redemption proceeds (Rev. Rul. 93-62, 1993-2 C.B. 118). If the exchange has the effect of a distribution of a dividend (determined with the application of § 318(a)), then the amount of the gain recognized that is not in excess of a Redeeming Shareholder's ratable share of the undistributed earnings and profits will be treated as a dividend. Section 356(a)(2). The Redeeming Shareholders will recognize no loss from the exchange. Section 356(c).
- (7) The aggregate basis of the Controlled Common Stock received by each holder of Distributing Common Stock pursuant to the Split-Off will be equal to such holder's adjusted basis in the shares of Distributing Common Stock surrendered, decreased by the amount of any cash received, and increased by (i) the amount treated as a dividend, and (ii) any gain recognized on the exchange (excluding the portion of the gain that was treated as a dividend). Sections 358(a)(1) and (b)(2).
- (8) The holding period of the Controlled Common Stock received by each holder of Distributing Common Stock pursuant to the Split-Off will include the holding

period of the Distributing Common Stock surrendered in exchange therefor, provided that such Distributing Common Stock is held as a capital asset on the date of the Split-Off. Section 1223(1).

- (9) Earnings and profits will be allocated between Distributing and Controlled in accordance with §§ 312(h), 1.312-10(a) and 1.1502-33(e)(3).

#### CAVEATS

No opinion is expressed about the tax treatment of the Split-Off under other provisions of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the Split-Off that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding whether the Split-Off: (i) satisfies the business purpose requirement of § 1.355-2(b); (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see §§ 355(a)(1)(B) and 1.355-2(d)) or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a fifty percent or greater interest in the distributing corporation or the controlled corporation under § 355(e)(2)(A)(ii).

#### PROCEDURAL STATEMENTS

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, instead of attaching a copy of this letter to a return, a taxpayer filing a return electronically may attach a statement to the return that provides the date and control number of the letter ruling.

In accordance with the power of attorney on file in this office, a copy of this ruling letter will be forwarded to your authorized representative.

Sincerely,

---

Michael J. Wilder  
Senior Technician Reviewer, Branch 1  
Office of Associate Chief Counsel (Corporate)